

AIR WAR COLLEGE

AIR UNIVERSITY

THE SPECTER OF AN OILY BEAR
OR
GEOPOLITICAL CHALLENGES OF THE MODERN RUSSIAN
PETRO-STATE

by

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BIOGRAPHY

LIEUTENANT COLONEL GREGORY S. CLAWSON

Lieutenant Colonel Gregory S. Clawson is a student at the Air War College, Maxwell Air Force Base, Alabama.

Col Clawson was born in Los Angeles and grew up in northern Ohio. He received his Bachelor of Arts in Computer Sciences from Cornell University in 1987 and was a distinguished graduate from the Reserve Officer Training Corps program. Col Clawson completed Undergraduate Pilot Training at Reese AFB in 1988 and has served as a T-38 Instructor Pilot, C-5 Evaluator Pilot, and C-12 Instructor Pilot. In addition to flying assignments, he was selected as an Olmsted Scholar and studied history at the Aristotelean University of Thessaloniki, Greece. Col Clawson also served as a Security Assistance Officer at the US Embassy Cairo, and as the Deputy Foreign Policy Adviser to the Secretary and Chief of Staff of the Air Force.

For over one hundred years, Russia has been a major oil producer. Regardless of the type of government – Czarist, Communist, nominal Democracy – oil has played a significant role in Russia’s economy as a valuable export commodity. With rapid industrialization following Stalin’s consolidation of power, it also became a significant commodity for domestic use. Eventually, Russians figured out that the natural gas that was associated with its oil fields was also of great value, and it too became a domestic and export commodity. With its expanded Eastern European empire, Soviet Russia discovered that its abundant supply of petroleum and natural gas granted it significant economic clout over its client states. Following the fall of the Soviet Union and Russia’s disastrous economic “reforms” of the 1990’s, growing state re-control of the oil and gas fields and distribution coincided with an increase in world prices. Russia found itself once again a superpower, only this time its coin of the realm was not military strength, but energy. However, to paraphrase *Spiderman*, with great power comes great responsibility, and the salient question regarding Russia’s resurgent position is: Will Russia act responsibly?

This work will present the development of Russia’s oil and gas industry, as well as examine the motivations and actions of its political leadership. In addition, subsequent chapters will look at European Union energy dependencies. Chapter 1 examines Russia’s energy history, beginning over a century ago in the Caucasus under the Tsars, then growing north and east under Soviet rule, and concluding in the present under post-communist Moscow. Chapter 2 examines the rise and fall of post-communist Russia’s “oligarchs” and their role in the dismembering and subsequent re-centralization and effective nationalization of Russia’s oil and gas industries. Chapter 3 explores Vladimir Putin’s perspective and influence, specifically with regard to

Russia's energy industry and its role in national policy. Chapter 4 shifts west to examine European energy security and the EU's growing dependence on Russian natural gas. Finally, Chapter 5 explores the possibilities and probabilities of Russia's using its energy as an economic weapon in its capacity as an energy superpower.

Throughout this work, while considering the central question of "Will Russia act responsibly?" the reader should also keep the following points in mind. First, since the break-up of the Soviet Union, the former republics of Belarus and Ukraine have been purchasing natural gas at a subsidized rate well below market price. From Moscow's perspective, there is no rational reason to continue subsidizing Kiev when it is turning its back on Russia and trying to associate itself with NATO and the European Union. In that light, Russia's demanding higher payments and cutting off gas flow is not bullying, but business.

Second, Russia depends on European markets to sell its oil and gas in order to generate hard currency. Russians have had a taste of consumer life since the end of communism, and there is no indication they wish to return to the old ways. Third, oil and gas must flow through pipelines from the fields in central Asia to either distribution networks or, for oil and liquefied natural gas, embarkation points. Pipelines, however, are extremely expensive to build. Therefore it is unlikely that gas from Sakhalin in the Far East will end up in Europe; there is no pipeline going west, and a southerly pipeline to China makes much more sense economically and logistically. At the same time, there is little chance that western Siberian gas will go to China any time soon for the same reason: the tyranny of distance.

Finally, as gas producing countries build more gas liquification facilities, and Europe builds more re-gasification plants, natural gas will become more divorced from its pipeline dependence. Like crude oil, it will be more subject to market forces and trade on the spot

market, rather than subject to long-term contracts. While this will allow Russia to export to areas outside of Europe, it will also allow the European Union to acquire natural gas from sources world-wide. Until Russia is able to complete a significant number of new gasification and port facilities, it will be dependent on its European customers to consume its Caucasian and Western Siberian gas. Europe, on the other hand, will have an increasing number of potential suppliers.

Russian Oil Production – Past and Present

From biblical times, areas in the Caucasus have produced bitumen and oil sands. Early traders prized the tars for their waterproofing characteristics and through the ensuing centuries the accessible petroleum contributed to lighting, heating, ship building, and medicine.¹ With its advances in basic technology and chemistry, the 19th century ushered in the age of refined petroleum products and the concordant wealth derived from their export and sale. Beginning in the 1830s the region around Baku in present-day Azerbaijan produced significant oil from relatively shallow wells.² Soon foreign oil-barons such as the Swede Robert Nobel and American John Rockefeller were active in the region, either buying oil or, by way of exploration grants from Moscow, developing new oil fields and exporting their produce.³

Over the next 50 years, Caucasus oil production-driven innovations included the first oil pipeline – to move crude oil from the fields to the Caspian shore – and the first oil tanker – to move the refined kerosene to the northern shore of the Caspian Sea.⁴ From there, it traveled by

¹ Mir Yusif Mir-Babayev. “Azerbaijan’s Oil History: A Chronology Leading up to the Soviet Era.” *Azerbaijan International*, Summer 2002,

http://www.azer.com/aiweb/categories/magazine/ai102_folder/102_articles/102_oil_chronology.html

², Robert Ebel. “The History and Politics of Chechen Oil.” http://amina.com/article/oil_op.html

³ Mir-Babayev, “Azerbaijan’s Oil History”

⁴, Marshall Goldman. *Putin, Power, and the New Russia: Petrostate*. New York: Oxford University Press, 2008, 19.

rail to Moscow and St Petersburg, providing light and heat to Imperial Russia's growing urban population. Increased Caspian production and the European demand for kerosene also prompted foreign investment in Russia's infrastructure. The French Rothschilds funded the construction of the trans-Caucasian railroad, providing an economical means to transport crude from the Caspian basin to the Black Sea, and from there by boat to their refinery on the Adriatic; European dependence on Russian oil had begun.⁵



The Nobel Brothers' oil wells in Balakhani, a suburb of Baku. The derricks were so close to each other, making the risk of fire eminent, and the noise level horrendous. Photo: Asbrink Collection.⁶

Russian domestic consumption of oil products was significantly lower per-capita than the industrializing countries of Europe or North America. As a result, more of its oil was available for the export market, with nearly forty percent flowing to Asia at the turn of the century. In that timeframe, Russia and the United States alternately were the largest oil producers in the world, accounting for 95% of global production in 1897. The following years, however, were not as

⁵ Ibid., 20.

⁶ Mir-Babayev, "Azerbaijan's Oil History"

kind.⁷

Due to the right geological conditions, oil extraction around Baku was both plentiful and very easy to accomplish. For that reason, Russian production was sloppy and wasteful; with such excess, spillage was not an economic issue. Also, the men responsible saw neither the need for, nor the benefit to importing up-to-date technologies. As the Baku oil field yields began to drop, exploration in what is now Chechnya and near the Black Sea was in the hands of foreign producers (Standard Oil and Nobels, primarily).⁸ Marshall Goldman distilled one of the recurrent themes in Russian petro-industry: “The drop [in production] was partly due to the failure of Russian companies to import the necessary technology. In what will turn out to be a recurring pattern, few Russian companies bothered to keep up with the rapidly changing refining and drilling techniques.”⁹ To compound these challenges, labor agitation, and then general social unrest in Russia significantly reduced oil production. “The climax came during the 1905 Russian Revolution. Two thirds of all the oil wells were destroyed...and exports were cut in half.”¹⁰ Following the 1917 Revolution and Bolshevik nationalization of the oil fields, production fell even further. From a 1904 high of over eleven million tons, Russian annual oil production dropped to under four million tons by 1920.¹¹

Soviet leadership soon concluded that possession of the fields was pointless without the expertise to extract the oil, and Lenin “personally approved ...extending concessions to foreigners.” American, German, French and British companies built pipelines, explored and drilled new fields, and built new refineries. In what was to become another recurring pattern of

⁷ Goldman, *Putin*, 21-22.

⁸ Mir-Babayev, “Azerbaijan’s Oil History”; Sergey Sergeyev. “Preserving the National Oil Industry Heritage.” *Oil of Russia, International Edition*, 2008, <http://www.oilru.com/or/34/671/>

⁹ Goldman, *Putin*, 22.

¹⁰ *Ibid.*, 23

¹¹ *Ibid.*, 6 (Chart of Russian and American annual oil production statistics from 1860 to 1964)

Russian behavior, once production and profitability had been restored, the Soviet government went about revoking the concessions it had granted.¹² It is worth noting that any Western oil company that was surprised by Russia's unfriendly business behavior over the last decade has only its ignorance of Russian history to blame.

An interesting historical aspect of communist control of the oil fields is that political ideology rarely impeded Soviet profit. In addition to accepting the presence and aid from distinctly capitalist (and therefore class enemy) foreign oil firms, the Soviet Union had no compunctions about selling petroleum to capitalist, and even fascist, countries. Prior to World War II, the Soviet fields were a primary supplier to Mussolini's Italy and in 1940, Soviet sales to Nazi Germany accounted for 75 percent of all Soviet petroleum exports that year.¹³ Once war between the two countries cut off the westward flow of oil, Germany eventually made a concerted effort to capture the Caucasus oil fields. However, the ensuing battles and subsequent Soviet victories left them damaged, with a significant impact on output. Stalin made recovery of domestic oil production a post-war national priority, and once again the Soviet Union asked for outside help. By 1950, Soviet production surpassed all pre-war levels and doubled 1945 production.¹⁴

Post-war Europe also presented a unique new situation for the Soviets. No longer did they need to concern themselves with hostile forces sitting on their borders. Instead, they had pushed out a strategic boundary allowing for defense-in-depth outside of Soviet territory. The European members of the Warsaw Pact provided Moscow with a comfortable buffer, and political domination of the German Democratic Republic eliminated their greatest historical

¹² Ibid., 26.

¹³ Ibid., 29.

¹⁴ N.A. Krylov, A.A. Bokserman, E.R. Stavrovsky, *The Oil Industry of the Former Soviet Union: Reserves, Extraction and Transportation*. Boca Raton: CRC Press, 1998, 73-74.

threat. However, maintenance of such an empire also required some substantial housekeeping tasks. One of those was supplying the Eastern European countries with oil and natural gas so that they would be dependent on the Soviet Union, and free of any encroaching economic ties with the West.

In addition, Moscow was able to use low-cost oil as an economic instrument of power, providing support to Castro's Cuba and opening doors in the third world for diplomatic initiatives and Soviet ideology.¹⁵ As a result, an interesting dichotomy developed, wherein the Russians behaved like capitalists beyond their imperial borders, but like communists within them. That is to say, the cost of oil and natural gas for their vassal states was significantly lower than the global free-market rate. Since oil production in the Soviet Union was a state function, there was no profit-based constraint on this use of oil to further its national interests.¹⁶ These actions drove a constant if somewhat inefficient cycle of exploration for more oil both to feed the Soviet domestic and satellite market and to sell abroad to generate hard currency for trade with the West. Fortunately for the Soviets, through the 1950s and 60s, new fields steadily if slowly came on line as the Caspian basin wells began to dry up.

Soviet oil production continued to increase throughout the 1970s, and in 1975 surpassed the United States as the world's largest oil producer. The 1973 oil embargo against the US and some European countries gave the Soviet Union its entrée into the industrialized West; the USSR had the oil and was happy to sell it for hard currency.¹⁷ The embargo also served as a wake-up call for European countries that had become largely dependent on inexpensive Middle Eastern oil. They looked for ways to diversify their sources, and the Soviet Union fit the bill. In addition to being separate from OPEC, Soviet oil also had the advantage of pipeline delivery –

¹⁵ Goldman, *Putin*, 44.

¹⁶ *Ibid.*, 45.

¹⁷ *Ibid.*, 46.

inexpensive and not vulnerable to blockades or other shipping threats. By 1980 the USSR was pumping over 12 million barrels of oil a day (more than the US or Saudi Arabia).¹⁸

While oil has a long history of both domestic use and export in Russia, natural gas is more of a late-comer. Initially, the Russian oil companies burned off, or flared, the gas that accompanied their petroleum and ignored huge pockets of known gas reserves. Typically during the Soviet era, the bureaucracy responsible for oil was not responsible for natural gas, and so made neither the effort to capture it, nor the effort to inform the gas bureaucracy of any finds.

Unfortunately for the USSR, the 1980s marked the end of empire. On top of its ill-fated expedition into Afghanistan and the culmination of decades of deleterious and ineffective central economic planning, its major source of hard currency – oil – had the rug pulled out from under it. Major North Sea oil fields came on line, Saudi production increased, and the price-per-barrel of oil decreased 60% from 1980 to 1989. Due to a variety of factors, some of them economic, the Soviet Union ceased to exist.¹⁹ The subsequent disintegration removed Moscow's control over the oil fields of central Asia. However, the newly born Russian Federation still possessed significant reserves; in 1991 it produced over 9 million barrels a day. Production decreased over 30% for most of the chaotic 1990's, bottoming out in 1996 at a mere 53% of the Soviet peak year 1987.²⁰ Russia underwent fiscal collapse under Yeltsin's alcoholic hand, and it was not until 2004 that oil again reached 1991 levels. That dramatic decrease resulted from the systematic pillaging of state industries by a handful of ambitious people who became known popularly as the "oligarchs."

Oil was a well-known Caucasian resource that the Tsars, Communists and Post-

¹⁸ Ibid., 34.

¹⁹ Gaidar, Yegor. "The Soviet Collapse," American Enterprise Institute for Public Policy Research, April 19, 2007, http://www.aei.org/docLib/20070419_Gaidar.pdf

²⁰, Adam Stuhlberg. *Well Oiled Diplomacy: Strategic Manipulation and Russia's Energy Statecraft in Eurasia*. Albany: State University of New York Press, 2007, 71.

Communists exploited. As the easy-to-acquire oil dried up, technology improved and Russia was able to increase yields in new fields. Under communism, Soviet oil and gas were instruments of economic power, tying the USSR's vassal states closely and providing incentive to developing countries to align with the Soviet bloc. The collapse of the Soviet Union coincided with a collapse in Russian oil production, in part due to economic reasons and in part due to the rise of the oligarchs and their subsequent dismembering of the Russian oil industry. The recovery was largely due to President Putin's re-establishment of state authority over Russian national resources.

Rise and Fall of the Oligarchs: Reformation and Counter-reformation

Following the Soviet Union's dismemberment under the final hours of Gorbachev's rule, Moscow found itself smaller and weaker almost overnight. Even worse, the economic juggernaut of centralized planning turned out to be just an illusion, and the Russian citizenry learned that the emperor was not only naked, but the road he was walking on was full of potholes. Though President George H.W. Bush was sympathetic to Russia's plight, he was in the middle of a battle for re-election with Bill Clinton, and had neither the time nor the political capital to spend on international issues.²¹

After assuming office, President Clinton made efforts to assist Russian president Boris Yeltsin. He championed International Monetary Fund loans to Moscow and arranged for American economic and political advisors to go to Russia and help them rebuild their country. However, President Clinton's security team's approach was essentially arrogant and disrespectful. They viewed Russia as the once dangerous, now pathetic town drunk who needed

²¹ Simes, Dimitri K. "Losing Russia: The Costs of Renewed Confrontation," *Foreign Affairs*, (November/December 2007).

help, but was no longer really a threat, and therefore no longer deserving of much of our attention. The conditions of the IMF loans were harsh; the intent was to induce some shock-therapy into Russia's economy.²² One of the central tenets of the loan conditions was the requirement for the state to divest itself from most, if not all industry. After all, how could Russia develop a free-market economy if the principle means of production rested in the hands of the state? This one wildly optimistic requirement was largely responsible for the upheavals and economic turmoil of the 1990s.

Theoretically, in a communist country, ownership of the means of production rests with the people. Therefore, when the state decides to divest itself of industrial ownership, to whom does the state sell it, and who gets the proceeds? Russia's solution was to issue ownership of each factory and state enterprise to that entity's employees in the form of 10,000 ruble vouchers which they could use to buy stock: all state businesses became "employee owned."

Unfortunately, seventy odd years of communism left the citizenry uneducated and unprepared for the transition. They neither understood nor appreciated the value of the papers they held, and many were willing to sell them for kopeks on the ruble in order to buy vodka, now-unsubsidized bread and other basic foodstuffs.²³ Unscrupulous people well trained to cheat under the old system and with a modicum of wealth were able to buy up entire factories at steeply discounted prices. In a country where Stalin's management and development style had leaned toward "one industry – one factory", the entire factory could very well represent the entire industry within Russia's borders.

These unscrupulous men came from two distinct groups: former government officials familiar with the bureaucratic knife-fights of the Soviet Union, and black-market entrepreneurs

²² Ibid.

²³ Goldman, *Putin*, 57-58.

quite familiar with the literal knife-fights of the shadowy side of the Soviet economy. Through different means they acquired factories, oil fields, refineries, and business connections; in less than a decade they went from modest to plutarchic means and became known as the oligarchs. Of interest for this study are the inroads they made into the oil industry and how they fared once Vladimir Putin came to power.

Of the top oil oligarchs, two – Vladimir Bogdanov and Vagit Alekperov – were former bureaucrats from the Soviet oil and gas ministry and had experience in the oil business. They gained control of their respective companies (Surgutneftegaz and LUKoil) by splitting off parts of the state oil and gas monolith and appointing themselves CEO. On the other hand, Vladimir Potanin (Sidanko Oil), Boris Berezovsky and Alexander Smolensky (Sibneft), Mikhail Fridman (Tyumen Oil – TNK) and Mikhail Khodorkovsky (YUKOS) were cut from a different cloth. Foremost, none of them had experience with oil; they were self-taught entrepreneurs intent on making a profit by removing as much wealth from their companies as possible. Whether that was by pumping and selling oil, or by breaking up and selling the parts of their companies does not appear to have been a difference to which they gave much thought.²⁴ Second, they were not “party men;” while Potanin and Khodorkovsky did serve in a modest fashion during the Yeltsin administration, they were not part of the Kremlin inner circle. Berezovsky, Smolensky, and Fridman were distinctly non-apparatchik; they built their pre-oil capital in grey and black market activities during the Gorbachev years.²⁵ Those five gained their oil empires by circuitous routes that all included founding their own banks, manipulating the evolving Russian tax codes, and then paying off the oil firms’ tax debts in such a manner that they were left with controlling

²⁴ Fiona Hill and Florence Fee, “Fueling the Future: The Prospects for Russian Oil and Gas,” *Demokratizatsiy*, vol. 10, no. 4 (Fall 2002), reprinted at http://www.brookings.edu/articles/2002/fall_globalenvironment_hill.aspx, 4-5.

²⁵ See Lee Wolosky, “Putin’s Plutocrat Problem,” *Foreign Affairs*, March/April 2000, as well as Hill and Fee “Fueling the Future” pages 20-22, for a good overview of Russia’s oil oligarchs.

interest in the companies. This was a ruthless time in modern Russia's development, and events like TNK's sending armed thugs to take over a rival company's oil fields were more common than not.²⁶ However, some of the oligarchs and their private armies began to believe in their own invincibility; they forgot that a State which retains the right and ability to use force retains power over the future of an individual.

As Yeltsin's health declined and his term came to an end, he appointed Vladimir Putin his Prime Minister. Putin quickly gained popularity with the Russian people by denouncing (and attacking) corruption and launching an aggressive military campaign against separatist Chechnya. Putin's calm demeanor and matter-of-fact approach to governing were a positive and stark contrast to Yeltsin's sodden bluster. Putin was also much younger, a sober teetotaler, and a fitness enthusiast: the anti-Yeltsin.²⁷ With his successor in place and comprehensive amnesty arranged, Yeltsin abruptly resigned on New Year's Eve, 1999, and Vladimir Putin became the acting president. From his position of authority and rather high visibility, Putin executed a successful campaign and, at the end of March 2000, began his first term as the elected president.²⁸ His rise to power coincided with an upturn in the price of oil, bringing significant wealth into Russia. However, that money did not all flow into her coffers; rather, much of it lined the oligarchs' pockets or went to foreign oil companies that had invested millions in developing the Russian fields.

Recall that in both Czarist and Soviet times, Russia was quite willing to allow foreign oil companies to bring in capital, equipment, and expertise, and to operate her oil fields. Russia was even willing to sign agreements that were quite favorable for the foreign companies, *when*

²⁶ Goldman, *Putin*, 69.

²⁷ Stuart D Goldman. "Russian Political, Economic, and Security Issues and U.S. Interests," Congressional Research Service, October 6, 2008, <http://www.fas.org/sgp/crs/row/RL33407.pdf>.

²⁸ Ibid.

Russia was weak. However, once the country gained some economic strength again, when it no longer felt that it had to bargain from a position of weakness, Moscow was quick to annul or renegotiate the agreements in its favor. After Putin's electoral victory and the rise in oil prices, Russia once again pressured foreign corporations to redefine their fiscal relationship.²⁹ However, President Putin did not stop there.

Several of the oligarchs had sold off portions of their oil companies to Royal Dutch Shell, ExxonMobil, BP, ConocoPhillips and others in the form of partial ownership and joint ventures. President Putin considered significant foreign ownership of Russian resources and industry a symptom of impaired Russia sovereignty and indicative of disloyalty by the oligarchs. He called some of the joint ventures colonial treaties and he made it clear that he thought the Russian officials who had authorized such arrangements should have been put in prison.³⁰ He embarked the government on a program to re-acquire controlling interests in those oil companies the oligarchs had creatively taken. In his university dissertation of 1997, Putin

“called on the Russian government to reassert its control over the country's abundant natural resources and raw materials...He viewed this as probably the best way to reestablish Russia's status as a superpower, an energy superpower. Instead of allowing the country's oligarch-controlled corporations to focus exclusively on making a profit, Putin proposed that they should be used instead to advance the country's national interests.”³¹

Now that he had attained power, Putin would use these “national champions” to rebuild Russian power and prestige; those oligarchs who did not wish to bend to the state's will would soon learn that they were no longer masters of their own fate.

In July of 2000, President Putin convened a meeting with many of Russia's newly wealthy oligarchs and explained to them explicitly that he would not delve into how they

²⁹ Hill and Fee, “Fueling the Future,” 22-24.

³⁰ M. Goldman, *Putin*, 86.

³¹ *Ibid.*, 97.

achieved their recent rise so long as they limited their activities to business and did not meddle in politics.³² The month before, the Russian police had arrested one of the media oligarchs, Vladimir Gusinsky, for dubious accounting practices. There is little doubt that Gusinsky's television and print media criticisms of Putin were the catalyst.³³ Between June's actions and July's briefing, most of the oligarchs understood their position. However, two of the major oilmen failed to see the light.

Berezovsky (Sibneft) and Khodorkosky (Yukos) each behaved in a manner guaranteed to attract the Kremlin's wrath. In addition to oil, Berezovsky owned a television network, ORT, which provided sensational and highly critical coverage of the Russian submarine Kursk incident. To make matters worse, while critiquing the government's response to the Kursk's plight, ORT juxtaposed pictures of the sailors' grieving families with footage of Putin enjoying a vacation on the Russian Riviera. Berezovsky believed that his wealth and highly placed friends rendered him immune to retaliation; however, ORT's coverage crossed a Putin red-line. Soon thereafter, word reached Berezovsky that Putin intended to have him arrested. Whether this was fact or a clever information operation will never be known, for before that could happen, Berezovsky went into self-imposed exile in Britain and relinquished control of his financial empire in Russia.³⁴ Khodorkosky, on the other hand, chose to spit in the bear's face.

During the "wild west" years of the 1990's, Khodorkosky and his henchmen were responsible for murder, intimidation, and conspiracy worthy of the mafia, not to mention questionable business practices and tax evasion. Within a short time, he was one of the

³² Ibid., 102.

³³ S. Goldman, "Russian Issues," 4.

³⁴ Michael McFaul and Kathryn Stoner-Weiss, "The Myth of the Authoritarian Model : How Putin's Crackdown Holds Russia Back", *Foreign Affairs*, January/February 2008, <http://www.foreignaffairs.org/20080101faessay87105/michael-mcfaul-kathryn-stoner-weiss/the-myth-of-the-authoritarian-model.html>; M. Goldman, *Putin*, 102-104.

wealthiest people in Russia and the oil company Yukos was his crown jewel. His past began to catch up with him in 2003 when Russian police arrested his chief of security, Alexei Pichugin, on several counts of murder. Shortly thereafter, Khodorkosky himself was jailed.³⁵ What caused Putin to turn his sights on Khodorkosky?

By all accounts, after 1999 Khodorkosky strived to make Yukos operations and finance transparent, even bringing in highly qualified foreigners as his CFO and COO to ensure Yukos met Western accounting and operating standards. Khodorkosky's downfall resulted from his behaving like a power above the restrictions of the State. For instance, he proposed building an oil pipeline in competition with the state-owned pipeline monopoly Transneft. Even more provocatively, he signed a twenty-year oil agreement with China without Kremlin coordination; in Putin's eyes Khodorkosky had just usurped the State's foreign policy prerogative.

Hammering another nail into his own gallows, Khodorkosky suggested he would sell approximately 50% of Yukos' stock to Exxon. Finally, in what can only be considered a monumental act of hubris (not to mention hypocrisy), Khodorkosky berated Putin during a television broadcast for running a corrupt and incompetent government, and then went so far as to suggest he might run against Putin for the presidency in 2004.³⁶ In the end, the government charged Khodorkosky and Yukos with multiple criminal charges including fraud and tax evasion; the courts found Khodorkosky guilty and sentenced him to nine years in the Siberian penal system.³⁷ In addition, the State went after Yukos' senior executives and many mid-level executives. Finally, Yukos itself was torn apart and auctioned off to cover back taxes and, by mid-2007, had ceased to exist. The valuable oil-bearing sections ended up in the state-owned oil

³⁵ M. Goldman, *Putin*, 108-110.

³⁶ M. Goldman, *Putin*, 116.

³⁷ S. Goldman, "Russian Issues", 4

behemoth Rosneft.³⁸

Following the fall of the Soviet Union, these clever though unscrupulous men manipulated the banking industry, tax codes, and state-owned industries in order to create oil companies and acquire the rights to oil fields at bargain-basement prices. While some of these newly rich came from the oil industry and understood it, others were simply businessmen looking to get rich. These immensely wealthy oligarchs wielded great power under Yeltsin. As noted above, Putin's ascension to the presidency was a sea change for the whole economy. He made it clear to the oligarchs that their behavior had better be either apolitical or supportive of Russia's national objectives. While most of them understood the new power structure, a few did not. The end result was the arrest or exile of several oligarchs and the re-centralization of their oil companies under Russia's state-owned oil industry. For this study, the tale of Khodorkosky's challenge and subsequent downfall is illustrative of President Putin's Russia and therefore germane to the question of "Will Russia behave responsibly as an energy power?"

The World from Putin's Perspective

As previously mentioned, President Vladimir Putin is the anti-Yeltsin. In a most un-Russian manner, he neither smokes nor drinks. Instead, he is adamant about his physical fitness and is an accomplished judo wrestler.³⁹ The West largely regards his election to office in 2000 as free and fair, and he received over 53% of the vote, more than double the next candidate.⁴⁰



³⁸ Ibid., 5.

³⁹ Erin Burnett, "The Russian Gamble", CNBC, aired December 11, 2008

⁴⁰ Michael Wines, "ELECTION IN RUSSIA: THE OVERVIEW; Putin Wins Russia Vote in First Round, But His Majority Is Less Than Expected", *New York Times*, March 27, 2000.

The Russian population sees him as personally incorruptible and as a nationalist who believes his duty is to restore Russia to its rightful place among nations. While the vote count in his 2004 victory is perhaps a bit more suspect, there is no denying that Russians continued to admire him; Putin's approval rate was over 70%.⁴¹ Put simply, Putin has come to personify a flourishing economy, better living conditions for the average Russian, and a slow but steady rebuilding of Russian military capability. The fact that political freedoms have decreased is viewed as the cost of doing business in order to achieve greater economic growth, stability, and security. To the average Russian, political freedom often seems to mean inevitable anarchy. In early 2008 Putin's approval rating neared 80% and many Russians wanted him to continue as president.⁴² This popularity and respect translates into legitimacy and a mandate to lift Russia up. Robert Kagan summed up Putin's strategic view and goals well in an August 2008 article:

Ever since [the Ukrainian and Georgian *Color Revolutions* of 2003 and 2004], Putin has been determined to stop and, if possible, reverse the pro-Western trend on his borders. He seeks not only to prevent Georgia and Ukraine from joining NATO but also to bring them under Russian control. Beyond that, he seeks to carve out a zone of influence within NATO, with a lesser security status for countries along Russia's strategic flanks..⁴³

Russia is not the Soviet military juggernaut of the Cold War; her petro-wealth no longer bankrolls a dominant military-industrial complex. Instead, Russia maintains an adequate conventional military for defense and small scale offense, such as Georgia or the ongoing war in Chechnya. Putin and his protégé Medvedev seem to be seeking a role for Russia as the great power in their immediate region, using the soft power of their reborn industrial and economic strength.⁴⁴

Another facet of the prism through which Putin views Europe and Central Asia is that of

⁴¹ Profile: Vladimir Putin (6 May 2008), available at <http://news.bbc.co.uk/2/hi/europe/667749.stm>

⁴² Michael McFaul and Kathryn Stoner-Weiss,

⁴³ Robert Kagan, "Putin Makes His Move," *The Washington Post*, August 11, 2008.

⁴⁴ Fiona Hill. "Moscow Discovers Soft Power," The Brookings Institution, *Current History*, (October 2006), and Padma Desai. "Putin's Russia," *Foreign Affairs*, (May/June 2008).

former imperial boundaries. Tsarist Russia acquired its territories in the Caucasus, including Georgia, after a prolonged and bloody struggle. The Ukraine is the historical birthplace of the Russian language and culture; Kiev was the seat of the Russian kings until they fled the steppes for the forests to get away from the Mongols. The Muscovite Tsars then incorporated the Ukraine into the empire in the 17th and 18th century. The Baltic States' bid for independence with the collapse of the Soviet Union was neither unexpected nor offensive. The conquest of the Baltics was not particularly difficult, and Latvians, Lithuanians and Estonians were not ethnically close to Russians. However, the Ukraine's departure from Russian was, from Putin's and most Russians' perspective, a slap in the face. To add insult to injury, both Georgia and the Ukraine actively courted NATO and sought membership in what Putin saw as a fundamentally anti-Russian alliance. Demanding that those two countries pay a fair market price for Russian petro-exports only made sense from Putin's perspective. Why should Russia continue to subsidize countries that had openly declared themselves as no longer friendly to her?⁴⁵

A number of trends have coalesced in the last fifteen years. Russian oil and gas production rose phoenix-like from the ashes of the Soviet system. The Kremlin reasserted its control over much of the commodities market, bringing the oligarchs to heel. Oil and gas prices increased, filling Russia's coffers and enabling it to pay off its foreign debt as well as build up substantial foreign currency reserves and start rebuilding a credible military. Finally Vladimir Putin proved to be a popular and strong leader capable of gathering all the reins of power and driving Russia toward his vision of restored prestige. One must wonder how this confluence of trends will affect European energy security and policy.

⁴⁵ See Robert Kagan "End of Dreams, Return of History" and "The September 12 Paradigm" as well as Dimitri Trenin "Russia Leaves the West" and Leon Aron "Russia's Next Target Could Be Ukraine."

European Energy Security

European dependence on Russian energy exports began in the 1970's following the oil embargo. Whereas the European countries had previously taken delivery of oil from the Middle East for granted, they now realized that their economies could be held hostage and, therefore, they needed to diversify their sources. However, Russian oil is not, nor is it likely to become, a threat to European autonomy. Russian oil reserves simply are not large enough, and suppliers can deliver oil to Europe through both pipeline and tanker. As a result, Europe can easily purchase oil on the spot market from a number of different companies or countries, preventing anyone from gaining a dominant supplier role.⁴⁶

Russian natural gas, on the other hand, does play a sufficiently large role in Europe's economy that it could prove to be the European Union's Achilles' heel. The EU needs gas, Russia has massive reserves of it, and pipelines are the most economical method for transporting it. As of March 2008, the European Union imported over 58% of its natural gas; Russian gas made up 45% of the EU's total use. Its dependence on outside sources will only increase with time, as it could possibly deplete domestic reserves by as early as 2016 at current consumption rates. Even with technological improvements and increased efficiency, the European Commission forecasts that the EU will need to import 84% of its natural gas by 2030. Unless Europe develops alternate sources of energy, its dependence on Russian gas will only grow.⁴⁷ One must wonder how Europe came to be so reliant so quickly on a country that, until only recently, was a strategic adversary. The answer is that this is not a sudden or new development; gas' entrée into the Western market was Soviet, not Russian.

⁴⁶ Fiona Hill and Florence Fee, "Fueling the Future: The Prospects for Russian Oil and Gas," *Demokratizatsiy*, vol. 10, no. 4 (Fall 2002), reprinted at http://www.brookings.edu/articles/2002/fall_globalenvironment_hill.aspx.

⁴⁷ Ida Garibaldi. "NATO and European Energy Security." American Enterprise Institute for Public Policy Research, *European Outlook*, March 2008, http://www.aei.org/publications/pubID.27719/pub_detail.asp

The USSR began exporting natural gas to its satellite states following World War II. The first export pipeline delivered gas to Poland in the late 1940s. Then, in 1967 the USSR completed pipeline connections to Czechoslovakia; the next year it began exporting to Western Europe with a twenty-year contract to Austria. In 1970, West Germany also signed a twenty year contract and the Soviet Union became a major player in European natural gas. Over the next decade, France and Italy joined West Germany, and Europe's integrated network of gas pipelines was carrying Soviet gas throughout the continent.⁴⁸ Through the Soviet collapse of the 1980s and turbulent rebirth of Russia through the 1990s, natural gas continued to flow. Unlike the oil industry, control of gas remained centralized under the state. In 1989, the Ministry of Gas formed a state-owned export company named Gazprom. When the ministry disappeared with the Soviet Union, Gazprom remained.⁴⁹

Gazprom came out of the Soviet collapse with two very valuable assets. As the state monopoly with authority for producing and exporting natural gas, it had access to the largest proven reserves in the world. Russia controlled over 32% of known global reserves and accounts for over 25% of global natural gas production. Its capacity is more than double the nearest competitor, Iran, and is more than eight times America's reserves. Equally important, Russia owned nearly 50% of all the gas pipelines in the world.⁵⁰ Therefore, Gazprom received control of the resource, its means of production, and its method of long-distance transportation.

While Gazprom had the means to intertwine itself with the European gas market, it could not assure its dominance of that market by itself. Like the mythological vampire, it could only enter if invited to do so. Following the turbulent Yeltsin years, Europe's governments were

⁴⁸ Gazprom Export. "Landmarks in History." <http://www.gazpromexport.com/history/?pkey1=00004>

⁴⁹ Goldman, 59-61.

⁵⁰ Stuhlberg, 66.

eager to work with Putin's more stable Russia.⁵¹ Industry leaders called on their governments to engage much more closely with Russia, for they anticipated its becoming the main supplier of gas. Think tanks and industry both called for a 'common economic space' and encouraged the EU to promote Russia's accession to the WTO.⁵² However, the EU and Russia are not ruled by the same body of law or the same traditions of government-industry relations. One of the major challenges the EU faces is Gazprom's territorial restriction clauses: if a nation receives more gas than it needs from Gazprom, it is not permitted to sell it to a neighbor. In effect, this would prevent Germany from supplying Poland if Russia decided to cut off gas to Poland as it did to Ukraine in 2006. The greater impact of the territorial restrictions is that it prevents the EU from acting as a unified entity in dealing with Russia; Moscow retains the ability to form agreements with individual countries and pursue a divide-and-conquer, or at least a divide-and-not-be-conquered, approach.⁵³

Another EU concern regarding Gazprom's sole control of Russia's gas is the reliability of future supplies. This particular concern is not related to politics, but to actual physical quantity. Russia's gas production has remained relatively flat since the mid-1990's, and Gazprom has not invested significantly in developing its gas fields. Thus, even though Russia has the largest proven reserves, its infrastructure may not be able keep pace with growing European demand.⁵⁴ Several of Russia's oil companies, both state owned and private (though national champion in nature) have major gas fields and gas associated with their oil fields. Unfortunately, Gazprom does not permit them to use its pipeline network, thus denying them access to the European

⁵¹ Katinka Barysch. "The EU and Russia: From Principle to Pragmatism?" Centre for European Reform, November 10, 2006, http://www.cer.org.uk/pdf/EU_russia_barysch_final_10nov06.pdf

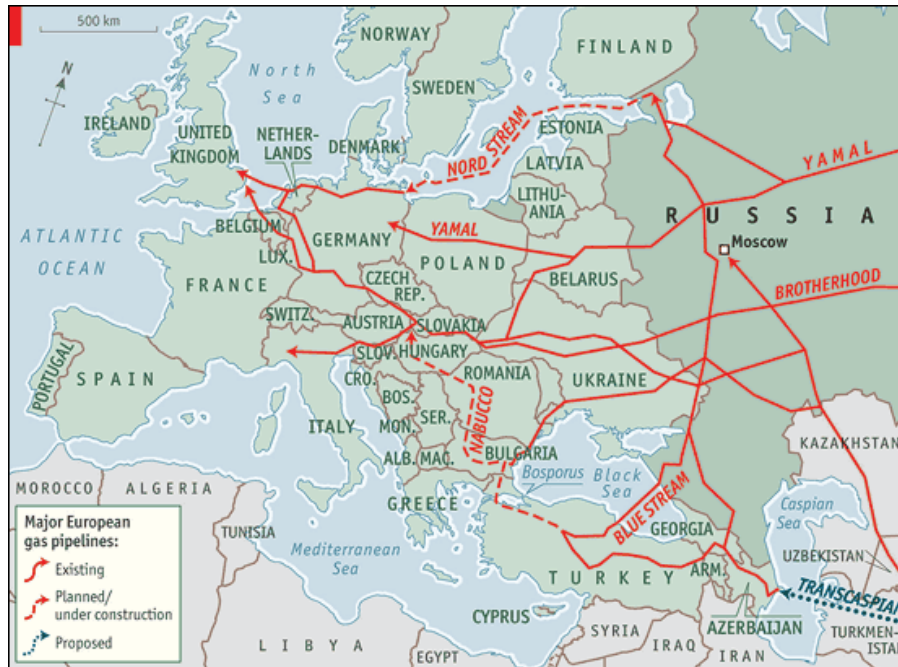
⁵² Nick Butler. "Energy Security: A New Agenda for Europe." Centre for European Reform, *CER Bulletin Issue 38*, October/November 2004, http://www.cer.org.uk/articles/38_butler.html.

⁵³ Charles Grant and Katinka Barysch, "The EU-Russia Energy Dialogue." Centre for European Reform, *Briefing Note*, May 2003, http://www.cer.org.uk/pdf/briefing_eu_russia.pdf.

⁵⁴ Garibaldi. "NATO and European Energy Security."

market. As a result, the companies are not developing their *gas* fields.⁵⁵

While physical supply is a concern, the issue of *political* supply has increased significantly since 2006. Victor Yushchenko's 2005 election as president of the Ukraine marked



Major pipelines flow gas from east to west. Germany and Poland receives their gas through Belarus, while southern Europe's flows through Ukraine. (*The Economist*)

a distinct cooling in Russian-Ukrainian relations; his preference for closer ties with the West to the detriment of Moscow was a central part of his platform. Moscow warned that Kiev was risking a decrease, or perhaps even end of, its gas subsidies; Kiev was paying less than a third of European Union price for natural gas. The Ukraine was welcome to draw away from Russia, but should not expect Russia to finance that move. In January 2006, Gazprom increased the Ukraine's gas price to the fair market value; not unexpectedly, Ukraine cried foul. Gazprom then decreased the gas flow through the pipeline transiting the Ukraine to just the amount necessary to supply its European contracts. Kiev continued to siphon off its requirements, leaving downstream customers cold and dark.⁵⁶ While from a legal, business, or diplomatic perspective, Russia's actions were justified, they sent a metaphorical chill down the European

⁵⁵ Charles Grant and Katinka Barysch, "The EU-Russia Energy Dialogue."

⁵⁶ M. Goldman, *Putin*, 144-145.

Union's spine. Even though Russia has reliably supplied natural gas for almost four decades, many Europeans are now fearful that this might change.⁵⁷

The other big concern in Europe is Russia's expansion into domestic pipelines and delivery. Gazprom is actively buying up transmission capacity. The 2007 natural gas crisis in Belarus was not for political reasons; Lukashenko stayed loyal to Moscow. However, Gazprom wanted ownership of the pipeline transiting Belarus and gave Minsk the choice: sell the pipeline or pay market price for the gas it was receiving. Gazprom has purchased large stakes or controlling interests in distribution networks in Italy, Germany, France and Italy. In addition, it is working on pipeline network ownership in Switzerland, Austria, Finland, Turkey, Hungary, Greece, Lithuania and Latvia.⁵⁸

To many in the EU, this expanding Russian monopoly is a greater concern than the possibility that Russia will close the pipelines for political reasons. Gazprom is behaving like the 19th century railroads in the United States. Figuratively, it wants to produce its own steel, make the rails and the train cars, and set the transportation rates. In that way, Gazprom's lock on profit cannot be threatened by political or economic actions from competitors. Various EU countries (France and Germany come to mind) are not keen on losing government control over pipelines within their own borders. If Gazprom controls the pipelines, it can determine if gas from other sources may flow through them. In essence, the fear is of an economic monopoly supplier, not a political bully.⁵⁹

One must ask, however, if Brussels is simply wringing its hands and fretting over possible doomsday scenarios? It is important to remember that Europe's growing dependence on Russia is not a one-way relationship. It is true that nearly half of the EU's imported natural gas

⁵⁷ Katinka Barysch. "The EU and Russia"

⁵⁸ Jonathan Stern, *The Future of Russian Gas and Gazprom*, (New York: Oxford University Press, 2005), 113.

⁵⁹ Barysch, "The EU and Russia"

comes from Russia. However, the reciprocal is that Russia depends on the eastward flow of hard currency to keep its balance of trade healthy and to subsidize reduced gas prices for both its domestic market and reduced-price foreign market.⁶⁰ Russia's gas fields in western Siberia all feed the European market; to ship it eastward to China would require over 7,000 kilometers of new pipeline, or a significant increase in Liquid Natural Gas (LNG) production.⁶¹ The EU would be more at ease if the Russian energy sector were more open to foreign investment and, therefore, review. However, the recent increase in oil and gas prices has allowed Russia to change course again, away from international cooperation and toward much more opaque operations. Instead of welcoming further investment and technology by making meaningful joint ventures, Gazprom, with the help of Russian state influences, has edged out western companies from several large-scale projects such as Sakhalin II (Shell and Exxon) and Kovykta (BP) in eastern Siberia.⁶²

The European Union is taking active steps to counter what it sees as an excessive dependence on Russian gas. The first, and perhaps easiest, step for the EU to take has been legal. The European Commission drafted an "unbundling" law, which prevents a company from forming a vertical monopoly; that is, it prohibits one company from producing, transporting and selling energy.⁶³ However, getting that law passed through the European Union's legislature has met challenges from France and Germany, who are determined to protect their own national interests as electricity-exporting countries.⁶⁴ A March 2007 conference on energy security called

⁶⁰ Stulberg, 70.

⁶¹ Barysch. "The EU and Russia"

⁶² Katinka Barysch. "Reciprocity will not secure Europe's energy." Centre for European Reform, *CER Bulletin Issue 55*, (August/September 2007), http://www.cer.org.uk/articles/55_barysch.html.

⁶³ Barysch. "Reciprocity."

⁶⁴ Ida Garibaldi. "Should NATO Defend Europe against Russia's Energy Weapon?" American Enterprise Institute for Public Policy Research (April 2, 2008) http://www.aei.org/publications/pubID.27910,filter.all/pub_detail.asp

for a centralized European Union energy regulatory body to oversee unbundling and ensure that energy companies operating within the EU complied with the rules.⁶⁵

In addition to regulatory steps, Europe is augmenting its pipelines connecting the EU to Norway, Algeria and Libya. There are also ongoing negotiations to construct a pipeline to bring Caspian basin gas through Azerbaijan, Georgia and Turkey, connecting into the pipeline network in southeastern Europe. The new conduit, called Nabucco, would completely avoid Russian territory, circumventing Gazprom's choke-hold on central Asian gas.⁶⁶ Furthermore, to overcome the strong reliance on pipeline-based supplies of gas, Europe is working hard to double its LNG re-gasification capacity over the next seven years. This will allow Europe to buy natural gas from around the globe; while improving the supply chain, it will also give the EU a better bargaining position vis-à-vis Moscow and Gazprom.⁶⁷

Where Do We Go from Here?

While the seven decades of East-West antagonism make it easy to imagine Moscow flexing its petro-muscles and forcing an EU country to make the choice between supporting an American initiative or continuing to receive natural gas, this paradigm probably does not reflect reality. The fundamental change in post-communist Russia's governing system has made it obsolete. During the failed communist experiment, commodities pricing within the Soviet Union and its satellite states was artificial; a central planning board decided how much resources cost, and who would receive them. Exports produced hard currency, which allowed Moscow to trade

⁶⁵ Academy of European Law. "EU Energy Policy: Striking the Balance between Supply Security, Climate protection, and Opening of the Market" March 27, 2007, http://www.era.int/web/en/html/nodes_main/4_1649_459/4_2153_462/events_2007/5_1625_3660.htm

⁶⁶ Garibaldi. "NATO and European Energy Security."

⁶⁷ Andres Cala. "Europe Looks to LNG." *Energy Tribune*, March 20, 2008, <http://www.energytribune.com/articles.cfm?aid=830>

with the outside world. However, behind the iron curtain, capitalist practices were forbidden. Today's Russia does not work that way; capitalism, profit and wealth are alive and well, and achieving personal wealth is an acceptable aspiration. The oil and gas companies produce a great deal of wealth for many individuals; those people have no desire to see an end to their privileged lifestyle. On the other hand, Putin's popularity and personal power, combined with his view that industry should support Russian policy, does mean that both privately owned "national champions" and state-owned companies will modify their business practices and pricing when doing so is a significant interest of the State, even if it means a temporary reduction in profits.⁶⁸ However, it is unlikely that Moscow will cease trading with the European Union for a number of reasons.

First, Moscow's actions toward Georgia, Belarus and the Ukraine should not be portrayed as the new norm, or even a major change in Russia's business practices. Those countries were receiving significantly discounted gas and, in Belarus' case, not even paying that reduced bill. However, an even more important factor in Moscow's behavior is the historical links Russia has with all three. It would be difficult to overstate the psychological trauma Russia suffered with the breakup of the Soviet Union. The people of Belarus, and nearly half the people of the Ukraine, are Russian! All three countries were core regions within Tsarist Russia, and the borders that defined the Soviet Socialist Republics were in many ways arbitrary. That those same borders ended up marking the geographic boundaries of Moscow's legitimate political power is a continuing affront to Russian nationalists. President Vladimir Putin, if nothing else, is a nationalist. From his perspective, Russian activity with those three is the geopolitical equivalent of playing in its own backyard.⁶⁹ Along those same lines, Russian coercive

⁶⁸ Interview with Lt Col Mike Zeiba and Col Alex Portelli, EUCOM Russia desk, 7 November 2008.

⁶⁹ Interview with Martha Patterson, Senior Economist, Office of Russian Affairs, State Department, 7 Nov 08.

diplomacy in the central Asian former republics – the so-called “balybystans” – is not at all expansionist *from Moscow’s viewpoint*.⁷⁰ Russia sees former Soviet republics as fundamentally different from European Union nations; it’s a different ballpark with different teams, and different rules apply.

The next category of countries to look at is the former Warsaw Pact. Following the collapse of the Iron Curtain, Poland, East Germany and Czechoslovakia distanced themselves as quickly as they could from Russia. East Germany’s scramble to re-unite with its Western half was quite understandable; however, Poles, Czechs and Slovaks are all slavs. Their anti-Russian sentiment is offensive to Moscow and, today, Russians view them with suspicion. In a recent survey, a Moscow-based polling organization found that Russians consistently viewed the Poles as one of Russia’s “greatest enemies”; the Baltic States and Poland are dangerous outposts of NATO eastward aggression.⁷¹ While the Czechs no longer share a border, in Russia’s eyes their behavior has been no better. Polish and Czech cooperation with the United States for a missile shield reinforces the “Aggressive NATO” viewpoint. It should come as no surprise that immediately following Prague’s signing of the missile defense agreement, the natural gas pipeline entering from the east suffered “technical difficulties” that shut down deliveries for two weeks. While the Czech Republic is a member of the EU, because the EU has not shown itself capable of being politically decisive as a unified entity, Moscow feels safe in giving Prague a little slap. This is not a case of playing in the *realpolitik* back yard, but more one of playing in the street directly in front of the house. It is still Russia’s neighborhood.⁷² The European Union’s best counter to this type of behavior would be to get its own house in order and act as a

⁷⁰ Stulberg, 93-94; OSD interview 7 Nov 08

⁷¹ Sergei Golunov. “EU-Russian Border Security: Stereotypes and Realities.” Edmund A. Walsh School of Foreign Service, Georgetown University, *European Strategy Project*, PONARS Eurasia Policy Memo No. 16, (August 2008), <http://ceres.georgetown.edu/esp/ponarsmemos/page/55901.html>.

⁷² Interview with Martha Patterson, Senior Economist, Office of Russian Affairs, State Department, 7 Nov 08.

single, indivisible energy consumption block, rather than as individual countries. Once the member countries adopt binding legislation, Gazprom's territorial exclusions will be null and void. Gas could then reach the Czechs, Poles, Hungarians, or any other former Warsaw Pact population through the European pipeline network regardless of any single Gazprom export pipe "technical difficulty."

In keeping with the law of unintended consequences, the EU's quest for diversified gas supplies and suspicion of Russia's reliability may prove to be a self-fulfilling prophecy. Europe has openly declared its goal to increase re-gasification capacity and has not been quiet about its misgivings toward Russia as an impetus for this move.⁷³ In response, Gazprom stated that it was considering halting construction of the Nord Stream pipeline under the Baltic Sea due to Europe's "mixed signals regarding Russian gas needs." Instead, Gazprom may build gas liquefaction plants in Western and Eastern Siberia, in addition to the project currently underway at the Shtokman Field in the Barents Sea north of Murmansk.⁷⁴ All three sites would be suitable for LNG production; receding polar ice will allow for easier ship access year round, and the colder ambient temperatures at the northern latitudes mean less energy required to liquefy the gas.⁷⁵ Ironically, such a move by Russia may be exactly what Europe needs to improve its energy security. Oil prices vary and are subject to price fluctuations, and good deals, in part because it can be traded in spot markets; pipeline-dependent natural gas is subject to longer term contracts due to the rather inflexible method of its delivery. LNG, on the other hand, moves around the world in large tankers in the same manner as oil. That, in turn, means energy distribution companies can purchase it. With an increase in re-gasification capacity, Europe can

⁷³ Cala. "Europe Looks to LNG."

⁷⁴ Reuters. "Gazprom may choose LNG instead of Europe pipelines." *Reuters.com*, (November 18, 2008). <http://www.reuters.com/article/rbssEnergyNews/idUSLI30263120081118>

⁷⁵ Gazprom. "Shtokman Project." <http://www.gazprom.com/eng/articles/article21712.shtml>

purchase its LNG from Russia, Qatar, or other LNG-producing countries. Because Russia still needs Euros and Dollars in order to trade with the rest of the world, Gazprom will sell gas to whoever is willing to buy it. If Russia does not, someone else will.

Conclusion

Russia is moving through turbulent stage in its rebirth. Moscow is not ready to give up its special influence in the former republics of the Soviet Union, or in the countries of its near abroad. However, Russians have taken a taste of the good life and are unlikely to return happily to Soviet-style social and economic isolation. Therefore, they are unlikely to support cutting off energy trade with the European Union over non-existential issues. Given that Europe is quite unlikely to threaten Russia, the probability of an existential threat coming from the West will remain low for the foreseeable future. Because oil can travel by ship as well as pipeline, and because Russia's cut of the global oil reserves is not overwhelming, Moscow's oil diplomacy does not pose a threat to European sovereignty. Europe's increased gas pipeline integration with Algeria and Libya as well as increased LNG capacity will help decrease its dependence on Russian gas. In addition, continued support for an alternate pipeline route from the Caspian basin and central Asia that avoids Russian territory would further circumvent Gazprom's chokehold on supply.

All these factors combined point toward a less overall threatening environment for Europe. The EU should continue to pursue a unified energy policy simply to prevent *any* company gaining a vertically integrated monopoly; that is just good business practice from a national perspective. However, the European Union should not spend a great deal of effort or concern over the long-term political reliability of Russian gas -- Moscow wants their Euros.

Afterword

The economic developments of the last several months have thrown a wild card into the European and Russian energy relationship. Fortunately for Russia, Moscow sequestered nearly half a trillion energy dollars in development and sovereign wealth funds. Moscow has been able to tap these funds in order to keep its banks afloat. In addition, Russian society continues to be largely a cash, rather than credit card, society, so the country is not saddled with great consumer debt.⁷⁶ This does not mean, however, that the average Russian is not being hit hard as the global economy flounders. The Russian budget's planning basis of \$70 a barrel for 2008 and \$90 for 2009 is now well wide of the mark.⁷⁷ Russia's need for money flowing in was probably one of the most significant factors leading up to January's repeat of the 2006 Ukraine gas crisis. Again, Moscow decreased gas flow and Kiev siphoned off what it wanted, leaving downstream customers in the cold. The EU got involved in negotiations, making its pique clear to both Moscow and Kiev. It is significant to note that the final agreement has Ukraine paying much higher prices for the rest of this year, and market prices thereafter. Apparently Brussels had no desire to fight for subsidized gas for Kiev while its own citizens either paid higher prices or did without gas at all.

⁷⁶ Burnett, "The Russian Gamble"

⁷⁷ Interview with Martha Patterson, Senior Economist, Office of Russian Affairs, State Department, 7 Nov 08.

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